



# SECURITIES ARBITRATION COMMENTATOR

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## Rethinking Non-Lawyer Advocacy in FINRA Customer Arbitrations

By Aegis J. Frumento and Stephanie Korenman\*

### Introduction

In the past six months, both FINRA and the SEC have issued warnings to investors against dealing with so-called asset recovery companies—firms that are not law firms or lawyers, but that sell services to recover investment losses, including through FINRA arbitration. FINRA warned bluntly, “In addition to the original money you lost, you now may lose more money at the hands of professional con artists.”<sup>1</sup> The SEC urged investors to “think carefully before paying money for asset recovery services that may be fruitless.”<sup>2</sup>

This is not a new thing. Twenty years ago, the Securities Industry Conference on Arbitration (“SICA”) noted with alarm the proliferation of such asset recovery companies.<sup>3</sup> SICA concluded that asset recovery firms were engaged in the unauthorized practice of law and urged FINRA (then the NASD) to pass a rule permitting them access to the arbitration forum only if permitted by the state where the arbitration took place.<sup>4</sup> That recommendation eventually found its way into FINRA Rule 12208 as it currently stands.

SICA’s recommendation and the current FINRA Rule were, we argue, missteps. The result has been that today, whether non-lawyer advocates are permitted to appear in FINRA arbitrations depends entirely on where the hearing is. To illustrate the problem, New York and Florida, the two most popular venues for

FINRA arbitrations, between them hosting a third of all FINRA hearings,<sup>5</sup> have reached directly opposite conclusions.<sup>6</sup>

Even worse than divergent state rules, only a handful of states have ruled on the question at all. This, too, is of FINRA’s making. Rule 12208(c) permits non-lawyers to appear unless “state law prohibits” it. Rule 12208(d) restricts challenges to the qualifications of representatives to “an appropriate court or other regulatory agency,” and prohibits stays of arbitration pending any such challenge except by a court order. So, unless one of the other parties starts a court action to challenge a non-lawyer advocate under state law, that non-lawyer remains able to act.

Rule 12208 thereby establishes non-lawyer advocacy as the *status quo*, and because it takes time, energy and money to change a *status quo*, no party, so far as we can tell, has, since Rule 12208’s adoption, challenged the qualifications of a non-lawyer advocate in a FINRA arbitration in any court anywhere in the country.<sup>7</sup> The consequence is that non-lawyers may appear as advocates for parties in FINRA arbitrations in most states by default—even though they may be engaged in the unauthorized practice of law by doing so, and even though they perpetuate a practice that SICA, FINRA and the SEC all view skeptically as not being in the best interests of investors.

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This is too fundamental a question to remain unsettled. Parties to FINRA arbitrations should by now know whether or not their paid advocates must be lawyers, and the answer should not vary by location. FINRA's rules control securities arbitration. It holds arbitrations in 70 cities in all fifty states, the District of Columbia and Puerto Rico. FINRA operates by grace of the federal securities laws and is a virtual subaltern of the SEC. Its arbitrations are mandatory upon industry participants—including especially customers—who are forced to forfeit access to the courts as the price of admission to the securities markets.

FINRA customer cases all arise out of a common, national understanding of the rights of the parties, largely rooted in common law principles, and in federal and state securities laws and regulations. Common sense argues for uniformity based on the FINRA forum itself, rather than disparity based on where the hearings just happen to take place. FINRA alone can set a uniform rule to govern who may appear as advocates in FINRA arbitrations.

1. The “Law of the Shop” or the “Law of the Land”?

Parties had been arbitrating cases for hundreds of years before FINRA came along. The practice apparently arose during the late Middle Ages, when merchants in France, England and Germany did most of their business at traveling trade fairs. Whenever disputes arose, they needed to be resolved quickly, for the very practical reason that the disputants needed to travel on. Arbitration

tribunals arose and resolved disputes by the quick application of the customs and usages of merchants rather than the technical law. By the early 17<sup>th</sup> century, the arbitration of disputes among merchants had become commonplace. Merchant arbitration was thereafter brought over to the American colonies and here it flourished.<sup>8</sup>

Most arbitration participants in commercial and labor arbitrations were “repeat players,” involved in arbitrations as an ongoing part of their businesses. Speedy and inexpensive resolution of disputes was more important than legally pristine outcomes. What mattered for decision-making was knowledge of the norms and customs of the industry of which all the parties were common denizens, not of the law writ large. Not surprisingly, then, neither arbitrators nor advocates were typically lawyers and few arbitration issues reached the courts.

The general legal consensus was that arbitrators were expected to apply the “law of the shop” and not the “law of the land.”<sup>9</sup> Moreover, for repeat players, the outcome of any one arbitration was not likely to put much at stake. Over the course of a lifetime of arbitrations, imperfect results in individual cases would eventually regress to an acceptable mean—win some, lose some, but come out even over time.

Over the past 40 years, however, a new kind of arbitration arose and FINRA customer arbitration is among them. Modern customer securities arbitrations are very different from the traditional

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ones between merchants. *First*, customers and brokers are not participants in the same industry, so there is no “law of the shop” to apply. Rather, customer rights are rooted in agency, negligence, contract, fraud, and federal and state securities statutes—very much the “law of the land.”

*Second*, customers are not “repeat players.” Most customers will only see one securities arbitration in their lives, so that, unless a claim is very small, the customer will have a lot at stake and no prospect of having an unfair decision made up for in later cases. As a result, customer arbitration has lost much of its informality and become increasingly “lawyerfied,” so that today it is nearly as procedural, protracted—and expensive—as real litigation. So, although it is still called “arbitration,” it has lost much of the look and feel of traditional arbitration and taken on much of the look and feel of litigation—and of legal practice.

Faced with these new forms of arbitration practice, the courts have generally adopted one of two models. One can be called the “rule-of-venue” model. This starts from the premise that lawyers *only* practice in courts of law; arbitrations are not courts of law; therefore, advocacy in arbitration is not “practicing law.” This is the model in New York. The alternative can be called the “rule-of-conduct” model, and it places primacy on how you conduct yourself. Basically, if you plead, analyze, and argue like a lawyer, then you are practicing law regardless of the setting. This is the model in Florida, Illinois, California and Arkansas.<sup>10</sup>

New York’s rule-of-venue solution appears to be well-established, but it rests on shaky foundations. Only a few federal court cases have dealt with the issue, and only in connection with out-of-state *lawyers* acting in New York.<sup>11</sup> Only one state court has even considered the status of a non-lawyer advocate, and only in the context of deciding that his status as a non-lawyer did not render his state-

ments any less privileged than those of any of the other participants in the arbitration.<sup>12</sup>

Curiously, the seminal case—Judge Weinfeld’s widely followed decision in *Williamson, P.A. v. John D. Quinn Constr. Corp.*—does not rely on any New York State cases, but on a 1975 New York City Bar Association Committee Report that concluded “representation of a party in an arbitration proceeding by a non-lawyer or a lawyer from another jurisdiction is not the unauthorized practice of law. Even if it is held to be the practice of law, there are sound and overriding policy reasons for permitting such non-lawyer representation in the labor arbitration field.”<sup>13</sup>

There are two main problems with the New York line of cases. *First*, they ignore the seminal New York case on out-of-state lawyering, where the Court of Appeals held that a California lawyer could not collect a fee for attending client meetings and giving advice to a client in New York because he was engaged in the unauthorized practice of law in New York—a case that reads for all the world like a “rule-of-conduct” decision.<sup>14</sup>

*Second*, the 1975 Bar Association Report on which the *Williamson* court relied dealt specifically with *labor* arbitrations, and indeed rested on an assertion that labor was a unique substantive area. Historically, labor arbitration is just the sort that adjudicated the “law of the shop” for repeat players.<sup>15</sup> As pointed out above, that traditional model of arbitration is very different from modern FINRA customer cases.<sup>16</sup>

The alternative “rule-of-conduct” model at least has the virtue of being substantively more coherent. That what one does should be more important than where one does it is intuitively appealing, so we should not be surprised that this model is in the ascendency.

The American Bar Association’s Model Rules of Professional Conduct gave impetus to this trend by enshrining in

Rule 5.5 on multi-jurisdictional practice of law the express permission for out-of-state attorneys to provide legal services on a temporary basis in connection with an arbitration, thereby affirming that arbitration practice was indeed the “practice of law.” The ABA Model Rules have been adopted, in one form or another, by most states.<sup>17</sup> While the Model Rules do not specifically speak to the activities of non-lawyers, a few jurisdictions have relied on Rule 5.5 to declare that non-lawyer arbitration advocates would be practicing law illegally.

Yet there are exceptions to both the “rule-of-venue” and the “rule-of-conduct” approaches rooted in a very practical concern—that the amount at stake matters. In New York and elsewhere, non-lawyers are routinely permitted to act as advocates in small claims courts, even though they are still courts.<sup>18</sup>

Likewise, even in a “rule-of-conduct” jurisdiction like Illinois, non-lawyer advocates routinely assist clients in obtaining unemployment benefits, despite the lawyerly tasks involved, because of “the informal nature of the proceedings, the minimal amount involved and the long history of participation by non-lawyer representatives. . . .”<sup>19</sup> And, as mentioned above, non-lawyer advocacy in union grievance proceedings is commonly accepted, no matter how much it looks and feels like practicing law.

It seems clear, therefore, that traditional arbitration, in which advocates need not have been lawyers, shared these two essential attributes: *First*, they dealt primarily with the norms and customs of participants in a common business—the “law of the shop;” and *second*, the stakes in individual cases were small.

Even today, when both those attributes are present, all states make exceptions, from whatever their stated positions on who is “practicing law,” to permit non-lawyers to represent parties—regardless of the formal nature of the forum as a court, or of the substantive

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nature of the task as fundamentally lawyer-like.

We think, therefore, that the proper way to address non-lawyer advocacy in FINRA customer cases is to look to those precedents rather than to a somewhat artificial and overly rigid “rule-of-venue” or “rule-of-conduct.” In FINRA customer arbitrations, the “law of the land” predominates over the “law of the shop;” therefore, non-lawyer advocates should be excluded unless the amount at stake is small.

#### II. FINRA Rule 12208 Does Not Help

The stock exchanges and the NASD historically treated arbitrations in the same way all merchants did—exclusively as a way of quickly resolving disputes between their members. The New York Stock Exchange first began offering arbitration services in 1817, but did not even permit customer access to them until 1872.<sup>20</sup> Thus, securities arbitrations were from inception typical of those where the “law of the shop” was applied to repeat players.

And, also typically, non-lawyer advocacy was expected and certainly permitted. The old NASD Code of Arbitration Procedure (Rule 10316) simply provided that all parties had the right to representation by counsel, but it made no distinction between lawyers and non-lawyers. In practice, securities arbitration was a “businessman’s forum” in which lawyers were more likely seen as a hindrance than a help.<sup>21</sup>

That changed dramatically when the Supreme Court ruled that customer arbitration agreements were fully enforceable, even to the extent of hearing federal securities law claims that had once been the exclusive province of the federal courts.<sup>22</sup> Today, there are almost twice as many FINRA customer cases as there are industry disputes. Clearly the “law of the shop” model that supported non-lawyer advocacy in the past—and that may still for industry cases—no longer holds for the vast majority of modern FINRA customer disputes.

With the influx of customer claims came complaints about non-lawyer advocates. Beginning in 1991, SICA received complaints about non-lawyer advocates filing frivolous claims and engaging in unethical practices, and ultimately concluded that non-lawyer advocacy “raised questions about the adequacy of the representation provided by [them], an issue vital to the integrity of the arbitration process.”<sup>23</sup>

In light of that, SICA originally proposed, in 1993, a rule that would have prohibited non-lawyer advocates except for friends, relatives, fellow employees of a party; officers, partners or employees of a corporation or partnership that is a party; and “a business advisor not regularly in the business of representing parties in arbitrations.”<sup>24</sup>

The proposed rule was published in the October 1993 issue of the *Securities Arbitration Commentator* and comments were received over the ensuing months. Non-lawyer advocates, as would be expected, unanimously opposed the new rule, arguing that arbitration was “an informal proceeding involving fact intensive issues which does not involve the practice of law.”<sup>25</sup>

SICA pulled back from its original recommendation, but for practical rather than substantive reasons. As a result of its fact-finding, SICA concluded that non-lawyer advocates were probably engaged in the unauthorized practice of law, engaged in misleading advertising, did not generally charge less than attorneys, did not offer the protections of attorney-client privilege, malpractice insurance and professional ethical constraints, and were often persons barred from the securities industry or from practicing law. “SICA is concerned about the adequacy of such representation and the integrity of the SRO [arbitration] process. As a practical matter, however, because of the large number of arbitration cases filed with the SROs each year, the SROs are not equipped to police or review the quality of such representation.” It therefore recommended a rule that permitted

non-lawyer advocacy unless prohibited by state law, or if the non-lawyer was suspended or barred from the industry or from practicing law.<sup>26</sup>

That recommendation eventually became FINRA Rule 12208. In explaining why it opted to permit non-lawyers to continue representing parties in customer arbitrations, NASD (FINRA’s predecessor) focused exclusively on affordability of representation for customers with small claims. “NASD understands that it may be difficult for investors with claims of less than \$100,000 to retain an attorney on a contingency-fee basis . . . . In these circumstances, NASD believes that investors should be able to seek other assistance to resolve their . . . claims for a reasonable fee.”

Among the non-lawyer advocates that NASD envisioned were expressly “a relative, friend or associate to represent or assist an elderly or disabled person . . . [and] . . . law school securities arbitration clinics. . . .”<sup>27</sup> But, of course, Rule 12208 does not provide for any such qualifications. So now, two decades after SICA first raised an alarm, non-lawyer advocates continue to ply their trade, and FINRA and the SEC continue to warn us about them.

#### III. A Modest Proposal for a Way Forward

What can we make of all this? It seems clear that the first thing we should do is abandon the “rule-of-venue” or “rule-of-conduct” approach. The better question asks neither what the advocate is doing nor where he or she is doing it, but rather *in what context is he or she doing it*. The context of the work yields a different set of questions, firmly rooted in traditional practice but also cognizant of what is really at stake: Is the context more concerned with the “law of the shop” or the “law of the land”? And, is the claim small enough to invoke a parallel with a small claims court? Answering those questions gets us to results that make a lot more sense in the real world. Here are some tentative conclusions:

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1. Non-lawyer advocates should be permitted in industry cases where “law of the shop” issues and repeat players predominate. Accordingly, FINRA Rule 13208 should stay as it is.

2. Non-lawyer advocates should be permitted in FINRA customer arbitrations that are to be determined by a single arbitrator under FINRA Rule 12401 and in Simplified Arbitration under FINRA Rule 12800. These cases have already been identified by FINRA as essentially “small claim” cases, so that the small claim court exception for non-attorney advocates is apt.

3. Non-lawyer advocates should not be permitted to appear in any other FINRA customer arbitrations, because all others involve a predominance of “law of the land” over “law of the shop,” and the amounts at stake are sufficiently large so as to place one-time players like customers at considerable risk.<sup>28</sup>

In light of that, we propose that the first sentence of subsection (c) of Rule 12208 be amended to read as follows: “Parties may not be represented in an arbitration by a person who is not

an attorney or a law student enrolled in a clinical program at an accredited law school under the supervision of an attorney, except if the arbitration is to be decided by a single arbitrator under Rule 12401 or is a Simplified Arbitration under Rule 12800, unless:”

and that Rule 12208(d) be amended to read in its entirety as follows: “Issues regarding the qualifications of an attorney or other a person to represent a party in arbitration are governed by this Rule and applicable law and may be determined by the arbitrators, an appropriate court or other regulatory agency. In the absence of a court order, the arbitration proceeding shall not be stayed or otherwise delayed pending resolution of such issues by a court or other regulatory agency.”

Yes, it really is that simple. SICA’s concern from 20 years ago about FINRA’s ability to police whether or not an advocate is a lawyer is outdated—indeed, it seems almost quaint given today’s technology. FINRA already has several Rules on its books that require it to determine if a party is an attorney,<sup>29</sup> and FINRA

Rule 12208(b) already provides the necessary “qualifications” of an attorney representative in FINRA arbitrations.<sup>30</sup> Moreover, as of April 3, 2017, all represented parties must use FINRA’s online DR Portal, which already requires attorneys to provide their State and Bar identification numbers.<sup>31</sup> DR Portal could be programmed to reject filings by non-lawyers, but even without such a feature, a representative’s status as a non-lawyer can be easily proved by adversary counsel in a motion to disqualify. FINRA would face no additional burdens like whatever concerned SICA back in 1995.

FINRA customer arbitration is a national enterprise enforcing nationally applicable laws, rules and regulations. Who should and should not be permitted to represent parties at FINRA arbitration hearings should not be subject to the vagaries of individual state interpretations of what it means to “practice law.” Only FINRA can act to impose uniform practice norms with respect to its arbitration proceedings. This is one way to do it.



### Endnotes

<sup>1</sup> FINRA Investor Alert, *It Can Be Hard to Recover from “Recovery” Scams* (updated Sept. 19, 2016), available at <http://www.finra.org/investors/alerts/it-can-be-hard-to-recover-from-recovery-scams>.

<sup>2</sup> SEC Investor Alert, *What You Should Know About Asset Recovery Companies* (Aug. 9, 2016), available at [https://www.sec.gov/oiea/investor-alerts-bulletins/ia\\_asetrecovery.html](https://www.sec.gov/oiea/investor-alerts-bulletins/ia_asetrecovery.html).

<sup>3</sup> See Securities Industry Conference on Arbitration, *Report on Representation of Parties in Arbitration by Non-attorneys*, 22 FORDHAM URB. L.J. 507, 512 (1995) [the “SICA Report”].

<sup>4</sup> *Id.* at 524.

<sup>5</sup> Excluding the current number 1 venue—San Juan, Puerto Rico—as being the anomalous consequence of the recent massive defaults on Puerto Rico bond issues. See FINRA Arbitration statistics available at [www.finra.org](http://www.finra.org).

<sup>6</sup> As to Florida, see *Fla. Bar Re Advisory Opinion on Nonlawyer Representation in*

*Sec. Arbitration*, 696 So. 2d 1178, 1997 Fla. LEXIS 970 (Fla. 1997); as to New York, see *infra*.

<sup>7</sup> The chairperson of a FINRA arbitration panel in Illinois did request, and he received, a Professional Conduct Advisory Opinion from the Illinois State Bar Association that non-lawyers who represent parties are engaged in the unauthorized practice of law. ISBA Opinion 13-03 (January 2013).

<sup>8</sup> See, generally, Sara Rudolph Cole, *Blurred Lines: Are Non-Attorneys Who Represent Parties in Arbitrations Involving Statutory Claims Practicing Law?* 48 U.C. DAVIS L. REV. 921, 939-40 (2015).

<sup>9</sup> *Alexander v. Gardner-Denver Co.*, 415 U.S. 36, 57 (1974).

<sup>10</sup> See, e.g., ISBA Opinion 13-03 at p. 6; “The character of the act done, not the place where it is committed, is the factor which is decisive of whether it constitutes the practice of law,” quoting *People ex rel Chicago Bar Ass’n v. Goodman*, 366 Ill. 346, 8 N.E.2d 991 (1937).

<sup>11</sup> See, e.g., *Prudential Equity Group, LLC v. Ajamie*, 538 F. Supp. 2d 605 (S.D.N.Y. 2008); *Williamson, P.A. v. John D. Quinn Const. Corp.*, 537 F. Supp. 613 (S.D.N.Y. 1982).

<sup>12</sup> *Depalo v. Lapin*, 2009 N.Y. Misc. LEXIS 5963 (Sup. Ct. N.Y. County, July 2, 2009) (unpublished opinion). It is interesting that the court’s first cited reason was “that FINRA regulations specifically permit parties to be represented by someone who is not an attorney . . .” *Id.* at \*6. Thus, the court held that non-lawyer advocates were not practicing law in FINRA arbitrations because FINRA Rule 12208 expressly permits them to practice there—a circular argument.

<sup>13</sup> Committee on Labor and Social Security Legislation, *Labor Arbitration and the Unauthorized Practice of Law*, 30 THE RECORD OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK 416, 422 (1975) [THE “1975 ABCNY REPORT”].

<sup>14</sup> *Spivak v. Sachs*, 16 N.Y.2d 163, 211 N.E.2d 329 (1965).

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<sup>15</sup> See generally, *In re Town of Little Compton*, 37 A.3d 85, 2012 R.I. LEXIS 16, 192 L.R.R.M. 3186 (R.I. 2012).

<sup>16</sup> The Association of the Bar of the City of New York reaffirmed the conclusion of the 1975 Committee Report as recently as 2008. Committee on Arbitration, *Unauthorized Practice of Law and the Representation of Parties in Arbitrations in New York by Lawyers Not Licensed to Practice in New York*, 63 The Record of the Association of the Bar of the City of New York 700 (2008) [the “2008 ABCNY Report”]. It did so even while acknowledging that the 1975 ABCNY Report referred only to labor arbitrations, and voicing concerns that since then arbitration has expanded to become “a big business” and “litigation by another name.” *Id.* at 746. One has the sense that the newer Committee did not want to disturb a conclusion that had been so prominently enshrined in judicial opinions.

<sup>17</sup> See American Bar Association CPR Policy Implementation Committee, *Variations of the ABA Model Rules of Professional Conduct, Rule 5.5: Unauthorized Practice of Law; Multijurisdictional Practice of Law* (as of Feb. 10, 2017), available at [http://www.americanbar.org/content/dam/aba/administrative/professional\\_responsibility/mrpc\\_5\\_5.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/mrpc_5_5.authcheckdam.pdf)

<sup>18</sup> See generally, 2008 ABCNY Report, note 16, at 704n.20 (2008).

<sup>19</sup> ISBA Opinion 13-03 at p. 6, discussing *Sudzus v. Dept. of Empl. Security*, 393 Ill. App. 3d 814, 914 N.E.2d 208 (1<sup>st</sup> Dist. 2009).

<sup>20</sup> See SICA Report at 508.

<sup>21</sup> Steven Lazarus, *et al.*, *Resolving Business Disputes: The Potential of Commercial Arbitration*, 52 AM. BAR ASS’N J. 169 (FEB. 1966) (BOOK REVIEW).

<sup>22</sup> *Shearson/American Express v. McMahon*, 482 U.S. 220 (1987).

<sup>23</sup> SICA Report at 512.

<sup>24</sup> *Id.*

<sup>25</sup> *Id.* at 514.

<sup>26</sup> *Id.* at 522-24.

<sup>27</sup> NASD Proposed Rule Change SR-2006-109, at p. 12 & n.11 (Sept. 14, 2006), available at <http://www.finra.org/industry/rule-filings/sr-nasd-2006-109>.

<sup>28</sup> There should be an express exception for law school clinic students operating under the supervision of a practicing lawyer.

<sup>29</sup> See, e.g., FINRA Rule 12208(c) (policing those who are suspended from the bar or disbarred); FINRA Rule 12602(b) (requiring representation of a non-party witness in an arbitration by an

“attorney”); FINRA Rule 12400(c) (giving special dispensation to chair-qualified arbitrators who have “a law degree and are a member of the bar of at least one jurisdiction”).

<sup>30</sup> We do not address how such rule changes would affect state laws governing the practice of law. The short answer seems to be that that a FINRA rule would likely preempt conflicting state laws. See Cole, note 8, at 968-971. FINRA asserted as much in its response letter to comment upon the publication of its proposed amendments to Rule 12208. See letter from Mignon McLemore to Nancy M. Morris, at p.2 (Sept. 17, 2007), available at <http://www.finra.org/industry/rule-filings/sr-nasd-2006-109>. In any event, it is highly unlikely that any state—including especially New York—would require FINRA to permit non-lawyers to represent claimants in arbitrations against FINRA’s own rules.

<sup>31</sup> FINRA Regulatory Notice 17-03, *Dispute Resolution Party Portal* (Jan. 2017). We leave aside as probably inconsequential the likely criminal conduct of non-lawyers masquerading as attorneys by entering false information into DR Portal. Eventually it may be possible for DR Portal to incorporate automatic look-ups to verify bar information in real-time, but even without that, we are confident that adversary counsel will spot the rare imposter without FINRA’s help.

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